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Accrual accounting does not necessarily mean accrual accounting: Factors that counteract compliance with accounting standards in Swedish municipal accounting

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Summary

The regulation of Swedish municipal accounting has undergone fundamental changes over recent decades. Municipal accounting became regulated by law the 1st of January, 1998 after having been merely voluntarily regulated in the past. In accordance with the legislation, a standard-setting body was formed, with responsibility for development and interpretation of generally accepted accounting principles for municipal accounting. Important aims of the legislation and reform were to suppress ‘creative’ accounting and to increase the level of harmonization and comparability. Using the lens of positive accounting theory as well as institutional theory, this paper describes and explains the impact of the legislation and standard setting in the Swedish municipal sector. We have used a triangulation approach, collecting data through a survey, documentary study and interviews. The overall results show that the reform has had a very limited impact on accounting practice. Compliance with accounting standards was in general poor. This result is in line with the assumptions of positive accounting theory. However, the study also shows that there are differences among the preparers which can be explained by institutional theory. Large municipalities produce better accounting information (i.e. more in line with generally accepted accounting principles) than the municipalities in general. Weak audit quality seems to be another important factor that explains the poor compliance with accounting standards.

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Introduction

Accrual accounting, i.e., where revenues and costs are recognized as they are earned or incurred, and not as money is received or paid, is an important part of the New Public

Management reform movement (Olsson et al., 1998); over recent decades many countries have changed from cash-based accounting towards accrual accounting in their public sector (see e.g., Lüder & Jones, 2003; OECD, 2000). This shift from cash to accrual accounting can be considered as a move towards managerialism (Broadbent & Guthrie, 1992) and associated with an endeavour to induce efficiencies into public institutions (Hopwood, 1984).

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The stimuli behind, and the processes regarding, these accounting reforms have been discussed and studied by several researchers (e.g., Bourmistrov & Mellemvik, 2005; Brorström, 1997; Falkman, 1998; Fihn, 1994; Lüder, 1992, 1994; Lüder & Jones, 2003; Monsen & Näsi, 1998a; OECD, 2000; Olson, Guthrie, & Humphrey, 1998). Thus, the origin and shaping of the formal set of rules and regulations, e.g., accounting norms valid for public sector accounting, has been thoroughly studied and elucidated. However, the actual impact of the reforms on accounting practice and among the preparers has not yet been given that much attention. The basic assumption is that accounting norms should control accounting practice/action (Bergevärn, Mellemvik, & Olson, 1995), but accounting is a social system and as such it tends to evolve by adapting to its context (AICPA, 1973; Bergevärn et al., 1995). This is applicable for both the norm system and the action system, which has to confront its context (Bergevärn et al., 1995). Thus, the accounting action system can be influenced not only through the norm system but also directly by its context. On the other hand, the norm system as well as the context can learn from the action system (Bergevärn et al., 1995). According to Bergevärn et al., the separation between the norm system, the action system and the accounting context is in line with the basic assumption of institutional theory.

An alternative, or complementary, perspective to the institutional theory is an economic theory based on self-interest. Positive accounting theory offers such an alternative or complement. The theory assumes that the relative power between agents and principals affects the choice and use of accounting methods. An agency problem exists in all organizational contexts, no matter whether they are commercial or political (Zimmerman, 1977). This problem arises whenever a principal delegates decision-making authority to an agent (e.g., Scott, 2003; Zimmerman, 1977). Politicians, who act in a political market, have to consider the voters and other stakeholders in their ambition to be re-elected (Downs, 1957). Since accounting choice affects the distribution of resources, it cannot be ignored that the self-interest of politicians in being re-elected and/or advancing their careers in the political system can affect accounting practice and compliance with accounting standards.

The aim of this paper is to describe and explain the actual outcome of the latest municipal accounting reform in Sweden by investigating the actual observance of the accounting regulation among the preparers. Further, we discuss the conceivable consequences of the outcome. Thus, we intend the paper to contribute to the debate and research within the field of public sector accounting reforms and move the focus from the design and stimuli behind the reforms on a regulative level (e.g., Bourmistrov & Mellemvik, 2005; Lüder & Jones, 2003) to a focus on adherence among the municipalities. As Sweden is one of the pioneers and early adopters of accrual accounting in the public sector (Lüder & Jones, 2003), and the implementation of accrual accounting in the public sector is a trend that is likely to continue during the years to come (Lüder & Jones, 2003; OECD, 2000; Paulsson, 2006), the Swedish case may be interesting and instructive for countries that belong to a later 'reform wave' or are about to start implementing accrual accounting in their public sector. In order to study

adherence among the municipalities, i.e. the preparers, we will investigate the compliance with accounting standards issued by the standard-setting body, the Council for Municipal Accounting, and statistically test hypotheses derived from institutional theory as well as positive accounting theory.

The paper is organized as follows: The following section describes the latest municipal accounting reform in Sweden. This section ends with the overall research questions of the paper. We follow up with a section describing the theoretical framework and the basis of analysis. Factors that may explain a possible observance gap are put in specific form through the derivation of hypotheses. In the section coming next we describe the methods used in collecting empirical data. A subsequent section presents the statistical analysis and the one next that presents implications from the statistical analysis, the documentary study and the interviews. In the last section we present the concluding remarks.

Municipal accounting reform in Sweden

What later became known as the New Public Management had its start in Swedish municipalities in the mid 1980s (Brorström, Haglund, & Solli, 2005). Municipal administration was decentralized, and the financial responsibilities were redefined and emphasized (Brorström et al., 2005). Even though Swedish municipal accounting was not regulated in law until 1998 when the Municipal Accounting Act (1997, p. 614) was executed, the need for regulation and reform of municipal accounting had been discussed since the early 1980s. In 1986, the municipal sectors voluntarily introduced an accounting model (Kf/Lf-86) which was based on accrual accounting. The co-ordination and development of the accounting model was led by the Association of Local Authorities through the issuing of guidelines, white papers, manuals and instructions. The development of municipal accounting was in many ways driven by a number of municipalities that constituted good examples (Brorström, 2007, chap. 7). However, the impact of this voluntary reform varied considerably across municipalities, and partly between different sub-operations within the same municipality. In order to suppress 'creative' accounting and increase the level of harmonization and comparability, the Swedish Parliament decided in 1997 to regulate municipal accounting through legislation. However, in contrast to the Bookkeeping Act (1999, p. 1078) and the Annual Accounts Act (1995, p. 1554) that regulates the accounting in the private sector, the Municipal Accounting Act does not have any connection to the penal code. Otherwise the legislation of private and municipal accounting is very similar. They are both types of framework legislation referring to standard-setting bodies in the wording of the law and in the preparatory legislative work. This has increased the importance of standards, decrees and guidelines from regulatory bodies. With the private sector as a model, a special standard-setting body with representatives from different stakeholders was founded in connection with the passing into law of the Municipal Accounting Act. This standard-setting body, the Council for Municipal Accounting, has been given the responsibility to develop and interpret the generally

accepted accounting principles within the municipal sector. Its authority is based on expertise and the association with the legislator (e.g., [Jacobsson & Sahlin-Andersson, 2006, chap. 12](#)). A municipality or county council that does not conform to a standard issued by the Council for Municipal Accounting must, according to the law, state this in the annual report and explain why it does not conform to the standard.

In Sweden we thus have an accounting model that should be used uniformly by all municipalities. The essential question of this study is whether the municipalities do or do not comply with the accounting standards issued by the Council for Municipal Accounting. Did the reform and the de jure implementation of new legislation and accounting standards also lead to de facto implementation in practice? What factors can explain a possible observance gap?

Theoretical framework

In research there are two main theories concerned with explaining accounting practice: positive accounting theory and institutional theory. According to [Neu and Simmons \(1996\)](#) the accounting literature relies heavily on positive accounting theory in order to explain managerial behaviour and accounting practice. However, within the context of public sector accounting, the theoretic institutional perspective has been seen as useful in order to explain accounting behaviour ([Bealing, 1994](#); [Carpenter & Feroz, 2001](#)). In this paper we argue that these two theories can be used as alternatives and/or complement each other in order for us to understand the conditions for, and the level of compliance with, accounting standards in the municipal sector (cf. [Collin, Tagesson, Andersson, Cato, & Hansson, 2004](#); [Neu & Simmons, 1996](#); [Tagesson, 2007](#)).

The basic assumption of agency theory is that it is based on self-interest. To understand how different accounting choices influence individuals and stakeholders, we need a theory about how rational individuals interact, with each and every individual acting in their own self-interest ([Jensen & Meckling, 1976](#)). The concept of agency provides the foundation of such a positive accounting theory ([Watts & Zimmerman, 1978, 1979, 1986](#); [Zimmerman, 1977](#)). The accounting system is closely linked to the agency problem, as accounting has the function of producing information for decision makers, such as shareholders and other stakeholders, and it has the function of distributing the results of production between agents and principals as well as to other stakeholders (e.g., [Collin et al., 2004](#)). Hence, positive accounting theory assumes that the choice of accounting solutions is affected by the relative power between agent and principal. In organizations with strong owners in control, accounting solutions that favour the principal are in use, while in organizations with weak ownership and limited control, accounting solutions that favour the agent are in use. Empirical studies using positive accounting theory have mostly focused on listed corporations. However, [Collin et al. \(2004\)](#) have shown that the theory can be used in explaining the choice of accounting standards in municipal corporations. Also [Zimmerman \(1977\)](#) uses positive accounting reasoning when explaining differences in accounting

information between municipalities that are run by mayors or city councils.

According to [Zimmerman](#), there is a reduced demand for information useful for monitoring municipal operations in comparison to corporations that depend on the capital market. In the public sector, the voters (the principals) have little use for accounting information. As there are restrictions on the sale of claims, the ownership cannot be concentrated in individuals willing and able to monitor the costs and benefits of public property. Furthermore, [Zimmerman](#) points out that there is no market for capitalization, which further reduces the principal's incentive to monitor the agent under public property rights. As stated by [Zimmerman](#), the politicians (the agents) will prefer an accounting system which allows them to report a selective subset of information to different groups. Besides, compared to the budget system, the accounting system has a hidden and less conspicuous role in municipalities ([Olsen, 1997](#); [Wildavsky, 1975](#)). Few documents imply so much work and attention as the municipal budget ([Brorström et al., 2005](#)). The budget process gets a lot of attention in the media and allows politicians to communicate and articulate ideologies to external stakeholders, such as taxpayers and voters ([Brunsson, 2002](#); [Olson, 1990](#)). The financial reports are characterized more by economic values than ideological ([Brorström et al., 2005](#)). Hence, from a political point of view the budget and the budget process are crucial since ideology legitimates action, and this in turn means financing ([Brunsson, 2002](#); [Olson, 1990](#)). In practice, ex-post accounting only seems to be loosely integrated with the budgetary system ([Olsen, 1997](#)). As political debates and ambitions tend to be future-oriented, it seems rational for politicians to give priority to budget process and documents before the accounting process and financial reports. Or as [Brunsson \(2002, p. 128\)](#) says '... in the future today's figures are irrelevant, and money is always in short supply.'

Thus, in compliance with agency theory, applied in the context of municipal operations, '... ignoring municipal accounting reforms is a rational act...' ([Zimmerman, 1977, p. 111](#)). Still, [Zimmerman](#) admits that institutional pressure can change the incentives for public officials and facilitate adherence to a reform:

... municipal accounting reforms will continue to be ignored until the reformers are able to specify changes in the institutional framework which provide different incentives for the public officials (or voters). The most obvious institutional change would be federal legislation... The impact of such legislation is, ultimately, an empirical issue. ([Zimmerman, 1977, pp. 134–135](#))

Then again, the non-existence of a connection between the Municipal Accounting Act and the penal code calls into question the effect of the law.

However, the level of compliance may differ across municipalities owing to dissimilar experiences of political or institutional pressure. Institutional theory assumes that organizations respond to pressures from their institutional contexts and adopt structures and practices that are socially accepted as the appropriate organizational choice and considered legitimate by other organizations in their fields ([Carpenter & Feroz, 2001](#); [DiMaggio & Powell, 1983](#); [Meyer &](#)

Rowan, 1977). This basic premise suggests a standardization and harmonization with certain predominant norms. Institutionalization is defined by Covalevski and Dirsmith (1988) as 'the processes by which societal expectations of appropriate organizational form and behaviour come to take on rule-like status in thought and action' (p. 562).

Legitimated structures and practices can be diffused to organizations through three different mechanisms (isomorphism): (i) *coercive*, inflicted by pressure from external organizations which the organization is dependent upon; (ii) *mimetic*, an imitation by modelling successful concepts in order to manage uncertainty; and (iii) *normative*, which stems primarily from members of a professional group's collective struggle to define the conditions and methods of their work (DiMaggio & Powell, 1983). DiMaggio and Powell point out that it is not always possible to distinguish the three mechanisms of isomorphic pressure from each other; two or more may be operating simultaneously, making it hard or even impossible to determine which mechanism of institutional pressure most strongly affects the institutionalization of a norm or practice. Therefore, many scholars choose a less detailed classification than DiMaggio and Powell (1983) and only distinguish between *coercive* and *voluntary* diffusion of institutional structures and practice (Modell, 2001; Oliver, 1991).

Oliver (1991) states that organizations do not always adapt to rules, myths and expectations from their institutional context. In her theory about how organizations strategically treat institutional pressure for change, Oliver assumes that political self-interest (cf. Downs, 1957; Zimmerman, 1977) plays a crucial role. Hence, depending on situation and possible consequences, organizations and their agents may respond in a variety of ways—ranging from passive conformity, compromise and avoidance, to defiance and proactive manipulation (Oliver, 1991)—to the normative and regulatory standards issued by a standard-setting body (e.g., Bergevärn et al., 1995).

Hypotheses

According to Bergevärn et al. (1995), accounting action is not only influenced by the accounting norm system but also by the context of the particular accounting system. Changes in the accounting norm system do not always have to be affected or recognized by the context of the accounting system. Hence, the early adoption of standards may not always be socially accepted and considered appropriate and legitimate by other organizations and stakeholders in the context. By awaiting adoption of the standards by other organizations in the field, it may be considered more legitimate to hold back from compliance with the standards until others have complied. Thus, there are arguments based on institutional theory that assume reluctance to change. Likewise, from the perspective of positive accounting theory, it can equally be argued that it is rational to await the change of other preparers before changing accounting practice in order to comply with new accounting standards. A change in the accounting action system can be assumed to bring about economic consequences. According to Christiaens (2002), the uncritical introduction of private

sector accounting methods and the apparent lack of a conceptual framework for governmental accounting creates problems rather than resolving them. To foresee and handle these consequences consumes time and resources. Thus, by early adoption the agent and organization will incur a 'cost of thinking' (cf. Luft & Shields, 2002). The uncertainty and attendant 'cost of thinking' will abate as other organizations start to observe the new standard. Consequently, arguments based on both institutional and positive accounting theory lead to a hypothesis (H1) that:

H1. Compliance with standards increases with time. Hence, the older the standard, the higher the observance.

According to Pfeffer and Salancik (1978), a good deal of an organization's behaviour can be understood by knowing something about its context and the problems it has in obtaining resources. The political survival of municipal politicians and officials depends on their ability to obtain resources from, and negotiate exchanges with, the context (Carpenter & Feroz, 2001). Hence, it is in the self-interest of politicians to be sensitive to demands and requirements from organizations in the context who make contributions to the municipality. One such organization is central government; approximately one-third of the Swedish municipal sector's income derives from central government grants.

Mizruchi and Fein (1999) argue that pressure from external stakeholders from which the organization is dependent on resources must be regarded as coercive pressure. Thus, organizations in the context who provide resources can exercise power over municipalities (Meyer & Scott, 1982). According to Carpenter and Feroz (2001), this power can be used to dictate the use of GAAP. The more dependent the organization is, the more pressure it will feel. Since many municipalities are dependent upon grants from the central government that issued the Municipal Accounting Act, both institutional and positive accounting theory support the second hypothesis (H2):

H2. The tendency of municipalities to comply with the standards issued by the Council for Municipal Accounting increases with the relative amount of income that the municipalities derive from government grants.

Size is another factor that we argue will affect compliance with accounting standards issued by the Council for Municipal Accounting. Opposing political action from central government can be assumed to draw attention to the organization and cause political costs for the organization (e.g., Watts & Zimmerman, 1978). The magnitude and extent of political costs is highly dependent on organizational size (Watts & Zimmerman, 1978). Media reports on municipalities' divergence from GAAP and legislation, along with high corporate profitability in the private sector, may trigger political costs for the organization. Furthermore, in large municipalities the political officials have less opportunity of exercising control through social control than in small municipalities, thereby putting emphasis on the quality and monitoring capacity of the accounting system (Cassel, 2000). Hence, on the basis of arguments from positive accounting theory, size should influence the political pressure that municipalities experience to comply with accounting standards issued by the Council for

Municipal Accounting as well as the pressure of an actual need for observance of a consistent set of accounting standards.

From institutional theory we argue that in large municipalities there are enough accountants to form a professional group to make it possible for them to struggle for their right and opportunity to define the conditions and methods of their work. The regulation of accounting offers a foundation for the formation of such a professional group (e.g., DiMaggio & Powell, 1983; Mizruchi & Fein, 1999). Finally, we claim that large organizations are much more closely examined and scrutinized by mass media, which increases the perceived normative and political pressure on these organizations. We therefore hypothesize (H3) that:

H3. The tendency of municipalities to comply with the standards issued by the Council for Municipal Accounting increases with size.

Oliver (1991) states that organizations do not always adapt to the rules, myths and expectations from their institutional context, meaning that political self-interest influences how organizations respond to institutional demand for change. Also Carpenter and Feroz (2001) emphasize the political interest in accounting. Many politicians on the national level start their careers at the municipal level. Opposition to the politics of one's own party does not normally seem to be a good strategy if you want to aspire to a political career. Besides, in many political parties it is an unwritten law and taken-for-granted concept not to go against party-political decisions at one's own discretion. For politicians representing the opposition parties, the social framework of norms and values as well as the self-interest in promoting a political career, the motive force may be the opposite. Consequently, we assume that political rule in municipalities influences the compliance with accounting standards and hypothesize thus (H4):

H4. Municipalities with the same political majority as the central government that issued the Municipal Accounting Act, are more inclined to comply with the standards issued by the Council for Municipal Accounting than municipalities with another political majority.

'Engaged auditor firm' is another factor that we assume will influence the compliance and application of accounting standards. Previous research on the private sector shows that auditors and auditing firms are important actors in the process of institutionalising accounting standards (Jönsson, 1985; Touron, 2005). The international auditing and consulting firms have played a crucial role in the process of implementing accrual accounting in the public sector (Christensen, 2005; Lüder & Jones, 2003).

As members of a professional group, auditors can be expected to put normative pressure on their clients in order to define the conditions and methods of their work (DiMaggio & Powell, 1983). As auditor firms only act as expert assistants to the politically appointed auditors in the work of auditing Swedish municipalities (e.g., Cassel, 2000), they cannot put coercive pressure on their clients by referring to their authority to decide whether the organization will get a qualified auditor's report or not (e.g., Meyer & Rowan, 1977). However, the recognition of the consultants'

perceived managerial and economic competence gives the consultants status and legitimacy (Christensen, 2005; Martin, 1998). The auditing firms can therefore be assumed to exert normative and mimetic pressure that may influence compliance with accounting standards. Culture and client portfolio may influence the audit habits of the different auditing firms; their auditors and models may by coincidence be diffused by auditing firms (e.g., DiMaggio & Powell, 1983). This leads to the following hypothesis (H5):

H5. The auditing firm influences compliance with accounting standards issued by the Council for Municipal Accounting.

Method

Data collection

Empirical data for the financial year 2003 were collected through an e-mail (questionnaire) survey and supplemented by secondary data from the Association of Local Authorities and data from the four major auditing firms (Deloitte, Ernst & Young, PricewaterhouseCoopers and KPMG); these data were complemented with data from municipalities that were not clients of one of the four major auditing firms. The variables collected from secondary sources were (i) number of inhabitants, (ii) turnover, (iii) net effect of government grants and reallocation between municipalities,¹ (iv) auditing firm and (v) political majority, with data referring to the income year 2003. All five variables were used in the non-respondent analysis. The survey was sent to financial directors of the municipalities. In total, 210 respondents out of the whole population of 290 municipalities answered the survey. Hence, the response rate was just over 72%.

The questionnaire was divided in two parts. In the first part we asked if the municipality fully complied with the respective standards issued by the Council for Municipal Accounting. The second part contained questions that aimed to control the reliability of the answers from the first part. In order to further control and evaluate the reliability of the survey data, 100 financial reports were chosen at random for study.

In order to test H1—if the compliance with standards increases with time—the average compliance in percent was calculated for each standard. The first standard still applicable (Standard 2) was issued in May 1999 and the last standard (Standard 15) was issued in April 2003. In order to test the other hypotheses, a deviation index was calculated with respect to the action by the municipality (a 'municipality deviation index').

The first part of the questionnaire contained questions about whether the municipality considered that it fully complied with the standards or not. The answers were codified as follows: Yes = 0; No = 1; Not applicable = missing value. The procedure made it possible to calculate the

¹In Sweden we have a system to equalize differences in economic condition between municipalities. Municipalities with a taxable capacity (tax base/number of inhabitants) lower than the national average will receive a grant from the central government, while municipalities with a taxable capacity above the national average will have to pay a fee to the central government.

Table 1 Correlation matrix of the quantitative variables (untransformed) used in the analyses ($N = 210$).

	1	2	3	4
1. Deviation index	1.000			
2. Net effect of government grants	0.130 ^a	1.000		
3. Turnover	-0.048	-0.251***	1.000	
4. Number of inhabitants (log)	-0.064	-0.274***	0.121	1.000

*Correlation is significant at the 0.05 level.

**Correlation is significant at the 0.01 level.

***Correlation is significant at the 0.001 level.

^aCorrelation is moderately significant at the 0.10 level.

number of deviations from standards for each municipality. The questions in Part 2 were control questions aimed to test the reliability of the answers in Part 1. From the answers in Parts 1 and 2 a modified deviation index was calculated. The answers 'no' and 'not applicable' in Part 1 were used unchanged in the modified index. The answers to the questions in Part 2 were used to judge whether a 'yes'-answer in Part 1 could be considered as reliable or not. By analysing the questions in Part 2, a 'yes'-answer from Part 1 can either remain a 'yes'-answer in the modified index or be recoded into a 'no'-answer. In this way a modified deviation index was calculated for each standard as well as for respective municipality.

Table 1 shows the correlation matrix of all the quantitative variables (untransformed) used in the analyses. The descriptions of the qualitative variables are shown in Tables 5–7.

Finally, the original and modified deviation indexes were evaluated and compared in relation to the results from the documentary study. The documentary study clearly indicated that, by using the modified deviation index in the analysis, we did not overrate the compliance with the accounting standards issued by the Council for Municipal Accounting.

Interviews

In order to obtain a deeper understanding and to further test the reliability of our statistical analysis, we conducted interviews with 12 financial managers. In order to obtain a richly varied picture from the interviews, we chose respondents from both small and large municipalities as well as municipalities with poor as well as relatively good compliance with the accounting standards issued by the Council for Municipal Accounting. The interviewees were presented with the data about compliance, generated from the survey and documentary study, and asked whether, from their point of view, they could explain the outcome.

Non-respondent analysis

To check the match between the respondent sample and the population, a number of statistical tests were applied. The Pearson Chi-square test was used to test whether the responding municipalities had the same distribution regarding engaged auditing firm or political majority as the

Table 2 Non-respondent analysis.

Variable	Mean	Standard deviation	N
<i>Number of inhabitants</i>			
Respondents	33 827	67 020	210
Non-respondents	23 398	27 674	80
Mann–Whitney: significance level	0.050		
<i>Turnover (millions, Swedish kronor)</i>			
Respondents	39 106	4050	210
Non-respondents	38 752	3839	80
Mann–Whitney: no significance			
<i>Net effect of government grants and reallocation between municipalities</i>			
Respondents	7168	5320	210
Non-respondents	7644	5499	80
t-Test: no significance			

non-responding municipalities. None of the tests showed any significance. Although it was noted that eight of the 290 municipalities did not engage any of the four major auditing firms. All these eight municipalities answered the survey.

For the variables of (i) number of inhabitants, (ii) turnover, (iii) net effect of government grants and reallocation between municipalities, the Kolmogorov–Smirnov Z test was used to evaluate whether the data were normally distributed. For the variables 'number of inhabitants' and 'turnover' the test showed that the data were not normally distributed ($p < 0.05$). We therefore used the Mann–Whitney U test as a substitute for the T-test in order to investigate possible non-respondent bias for those two variables. The variable 'net effect of government grants and reallocation between municipalities' turned out to be normally distributed ($p = 0.146$). To investigate a possible non-respondent bias for this variable we used the traditional T-test. The results of the tests are shown in Table 2.

With reference to turnover, net effect of government grants and reallocation between municipalities, auditing firm and political majority, the non-respondent analysis

shows that the sample can be considered as a representative sample of the whole population. However, the tests for number of inhabitants show a bias towards municipalities with higher numbers of inhabitants. If we presume that number of inhabitants has a strong explanatory power with respect to compliance with accounting standards, this bias could mean that the results of the analysis could have been more distinct if we had obtained data from the whole population.

Statistical analysis

Compliance with accounting standards issued by the council for municipal accounting

The overall results show that average compliance is consistently lower according to the modified compliance index (69.7%) than according to the index based on the questions in Part 1 of the questionnaire (89.8%). The impression based on the documentary study strengthens the apprehension that the compliance is considerable lower than the answers from Part 1 of the survey indicate. Our conclusion is that the average compliance is below 70%. Even if the law states that deviations from accounting standards must be reported and explained in the annual report, only 11% of the deviations were reported. Compared to earlier surveys for financial years 1999 and 2001 (see Haglund, 2002) it seems to be the same accounting standards (Standard 2 on accounting for pensions, Standard 7 on disclosure of pension obligations and pension funds, and Standard 11 on accounting for property plant and equipment) that have a limited impact on accounting practice. Furthermore, Standard 13 concerning leases also seems to have had a limited impact on accounting practice. Compliance with these standards, according to the modified compliance index, is less than 50%. Common to these standards, with exception of Standard 13, is that the applications of the standards have a material influence on the municipalities' earnings and financial position. Pension provisions and management of pension funds have been, and still are, politically delicate subjects. Many municipalities have not made provisions to the same extent as their actual obligations towards the employees have increased (e.g., Brorström, 1997).

On the basis of this analysis we can conclude that the accounting standards issued by the Council for Municipal Accounting have had a limited effect on accounting practice.

Reluctance to change

Comparison with previous surveys from the financial years 1999 and 2001 indicates that compliance does not increase with time. In order to systematically test the first hypothesis that compliance with standards increases with time, a variable was created based on the time when each standard was issued. The oldest standard was coded '1'. The standard issued a month after the oldest standard was coded '2', and so on. The time index was used as the independent variable, and the modified compliance index based on the standards was used as the dependent variable. (An alternative

Table 3 Correlation between compliance with accounting standards in % and time (measured in months) since the standards were issued.

	Modified standard compliance index	Time
Pearson correlation	1	0.076
Significance (2-tailed)		0.795
N	14	14

operationalization of the time index would have been using number of years since issue of the standard. We also conducted this test, but it did not show any different result ($p = .809$). A Pearson correlation test and a linear regression analysis were used to test the hypothesis. None of the tests showed any significance. The results of the Pearson correlation test are shown in Table 3.

Hence, the hypothesis that compliance with standards increases by time must be rejected. The defective compliance cannot be explained by reluctance to change. Compliance will not increase by time unless actions are taken.

Government grants and size

Hypotheses 2 and 3 assumed that there was a correlation between compliance with the standards and the relative amount of income received from government grants and reallocation between municipalities, as well as between compliance with the standards and size of the municipality, respectively. The impact of the factor of size was investigated by using the variables 'number of inhabitants' and 'turnover'. As none of these variables were normally distributed, we used the log of the number of inhabitants and turnover. As dependent variable we used the modified deviation index based on the number of standards each municipality deviated from. Thus, a negative correlation between the dependent and the independent variables was expected. The hypotheses were tested by using linear regression and Pearson correlation test. The only variable that showed any significance in line with the hypotheses was number of inhabitants. However, the explanatory power was relatively weak ($R^2 = 0.024$). The results of the Pearson correlation test are shown in Table 4.

Thus, we must reject Hypothesis 2—that the tendency of municipalities to comply with the standards issued by the Council for Municipal Accounting increases with the relative amount of the income of the municipalities that derive from government grants. On the contrary, the statistical test shows a moderately significant correlation in the opposite direction ($R^2 = 0.017$).

Whether Hypothesis 3—that municipalities' tendency to conform to the standards issued by the Council for Municipal Accounting increases with size—can be rejected or not is less clear. The analysis indicates that size matters, at least when it is measured by number of inhabitants. The documentary study and the interviews strengthen the

Table 4 Correlation between compliance with accounting standards and the factors of government grants and size.

	Modified municipality deviation index	Net effect of government grants and reallocation between municipalities	Turnover (log)	Number of inhabitants (log)
Pearson correlation	1	0.130	-0.045	-0.154
Significance (2-tailed)		0.061	0.513	0.026
N	210	210	210	210

Table 5 Connection between political majority and compliance with accounting standards.

Political majority	Mean (deviation from accounting standards)	Std. deviation	N
The conservatives and liberals	3.81	1.64	69
Indistinct	3.98	1.80	45
The green party in holding the balance of power	3.65	1.27	17
The social democrats and the left-wing party	3.95	1.48	79
Total	3.89	1.58	210

impression that size matters. The documentary study shows that the quality of the financial reporting in general is better among the big municipalities, and the interviews indicate that the awareness of and competence in accounting are better among larger municipalities than in smaller ones.

Political majority

Hypothesis 4 posited that municipalities with the same political majority as the central government, which issued the Municipal Accounting Act, were more inclined to apply to the standards issued by the Council for Municipal Accounting than municipalities with another political majority. As shown in Table 5, political majority does not impact the level of compliance with accounting standards issued by the Council for Municipal Accounting.

As there is no significant connection between political majority and compliance with accounting standards issued by the Council for Municipal accounting, the hypothesis must be rejected.

Auditing firms

The fifth hypothesis (H5) was based on knowledge from previous research that auditors and auditor firms influence the judgement and choices of clients regarding accounting and reporting. Apart from the four major auditor firms, there was one small independent auditor firm with one

Table 6 Connection between engaged auditor firm and compliance with accounting standards.

Auditing firm	Mean (deviation from accounting standards)	Std. deviation	N
PwC	3.92	1.54	142
KPMG	4.29	1.64	35
Ernst & Young	3.60	1.81	20
Deloitte	3.00	1.22	5
Small national auditing firm	2.00		1
Own auditing office	3.00	1.15	7
Total	3.89	1.58	210

client, and seven municipalities with their own auditing offices. As shown in Table 5, PricewaterhouseCoopers (PwC) dominated the market, followed by KPMG and Ernst & Young. Deloitte had a relatively small market share with only slightly more than 2% of the market.

The mean values in Table 6 indicate some degree of connection between engaged auditor firm and compliance with accounting standards. In order to test this connection we had to recode the variable into fewer groups. Two Mann–Whitney tests and one Kruskal–Wallis test with different groupings of the variable are shown in Table 7.

Regrouping of a variable can always be questioned. Therefore we have done several analyses with the independent variable grouped in several different ways. As shown in Table 7, all the test results indicate that we could not exclude a connection between engaged auditor firm and compliance with accounting standards issued by the Council for Municipal Accounting.

Hypothesis 5—that auditing firms influence the compliance with accounting standards issued by the Council for Municipal Accounting—cannot be rejected.

Multiple regression

In addition to the bivariate tests, a multiple regression was conducted including those variables that indicated significance in the bivariate tests. For the factor 'auditing firm' three dummy variables were created; PwC, KPMG and Ernst & Young. The remaining auditing firms, including those with their own auditing office, were used as reference group.

The correlation matrix of the variables in Table 8 indicates support of the hypothesis that there is a correlation between compliance with the standards and size of the municipality when size is measured by number of inhabitants (log). The correlation matrix also supports the findings in the bivariate analysis that there is a moderately significant correlation between net effect of government grants and deviation from accounting standards: the more received grants, the more deviations from the accounting standards. The correlations between the independent variables indicate the presence of a collinearity problem.

As shown in Table 9, the regression model is significant ($p = 0.044$). However, the variables ‘net effect of government grants’ and ‘number of inhabitants (log)’ are not significant. One possible explanation may be the collinearity

problem mentioned above. In the collinearity test, the variable ‘net effect of government grants’ has a tolerance value of 0.596, and the variable ‘number of inhabitants (log)’ has a tolerance value of 0.608. The dummy variables PwC and KPMG are significantly separated from the reference group. This strengthens the hypothesis that auditing firms influence compliance with accounting standards issued by the Council for Municipal Accounting.

In order to deal with the collinearity problem between the variables ‘net effect of government grants’ and ‘number of inhabitants (log)’, two more regression models were tested. The model excluding the variable ‘net effect of government grants’ shows significance ($p = 0.036$). However the variable ‘number of inhabitants (log)’, which now has a tolerance value of 0.920, is still not significant ($p = 0.113$).

The analysis, reported in Table 10, shows that the significance of the regression model increases slightly ($p = 0.027$) when the variable number of inhabitants (log) is excluded. The significance of the included variables increases, the variable net effect of government grants now show a moderate significance ($p = 0.077$), and the tolerance value increases to 0.902. In contrast to the dummy variables PwC and KPMG, the dummy variable for Ernst & Young does not show any significant divergence compared to the reference group.

The multiple regressions strengthen the conclusions generated from the bivariate analyses. The results from the analyses can be summarized as follows: The probability that a municipality will comply to standards issued by the Council for Municipal Accounting increases if the municipality (i) is not a net receiver of government grants, (ii) has many inhabitants, and (iii) does not engage PwC or KPMG as its audit firm. However, the explanatory power of these variables is still relatively weak.

Implications from the survey, documentary study and interviews

The overall results show that so far, the reform seems to have had limited impact on accounting practice. Both the survey and the documentary study show that compliance with accounting standards in general is less than 70%. The level of compliance varies considerably across accounting standards. However, these differences in level of

Table 7 Connection between engaged auditor firm and compliance with accounting standards, with different groupings of the variable ‘auditing firm’.

	Mean (deviation from accounting standards)	Std. deviation	N
PwC and KPMG	3.99	1.56	177
Other auditing firms including own auditing offices	3.33	1.59	33
Mann–Whitney: significance level 0.039			
PwC, KPMG and Ernst & Young	3.95	1.59	197
Deloitte, Small auditing firm and own auditing offices	2.92	1.12	13
Mann–Whitney: significance level 0.017			
PwC	3.92	1.54	142
KPMG	4.29	1.64	35
Ernst & Young	3.60	1.81	20
Deloitte, Small auditing firm and own auditing offices	2.92	1.12	13
Kruskal–Wallis: significance level 0.067			

Table 8 Correlations from multiple regression ($N = 210$).

	1	2	3	4	5	6
1. Deviation index	1.000					
2. Net effect of government grants	0.130 ^a	1.000				
3. Number of inhabitants (log)	-0.154*	-0.573***	1.000			
4. PwC	0.027	0.231***	-0.152*	1.000		
5. KPMG	0.113	-0.050	-0.061	-0.646***	1.000	
6. Ernst & Young	-0.059	-0.295***	0.116 ^a	-0.569***	-0.154*	1.000

*Correlation is significant at the 0.05 level.

**Correlation is significant at the 0.01 level.

***Correlation is significant at the 0.001 level.

^aCorrelation is moderately significant at the 0.10 level.

Table 9 Regression of deviation from accounting standards ($N = 210$).

	Coefficient	Standard error	t-Value	Significance
Constant	3.837	1.777	2.160	0.032
Net effect of government grants	0.000	0.000	1.046	0.297
Number of inhabitants (log)	-0.236	0.345	-0.685	0.494
PwC	0.861	0.471	1.829	0.069
KPMG	1.268	0.530	2.393	0.018
Ernst & Young	0.745	0.584	1.275	0.204
R^2 /Adj. R^2 /F-value/sig.	0.232/0.054/2.324/0.044			

Table 10 Regression of deviation from accounting standards when the variable number of inhabitants (log) is excluded ($N = 210$).

	Coefficient	Standard error	t-Value	Significance
Constant	2.661	0.456	5.837	0.000
Net effect of government grants	0.000	0.000	1.779	0.077
PwC	0.950	0.451	2.150	0.039
KPMG	1.375	0.505	2.721	0.007
Ernst & Young	0.850	0.563	1.510	0.132
R^2 /Adj. R^2 /F-value/sig.	0.227/0.052/2.795/0.027			

compliance among different standards cannot be explained by the time the standard has been in effect. In order to find complementary explanations to the insufficient compliance with accounting standards issued by the Council for Municipal Accounting, we presented the overall results of the survey and documentary study to 12 financial managers. From the interviews we received information and explanations about the poor compliance. The answers were similar among respondents. All respondents stated that financial accounting, especially the annual financial report as a document, was not considered to be a priority. One manager put it this way: 'The annual accounts are produced during a very hectic period of the year in order to then be forgotten.' Another manager stated that '...nobody actually reads the annual report.' The overall impression among the financial managers was that interest in the annual accounts was very low—the budget was the priority document.

A good deal of an organization's behaviour can be understood by knowing something about its context and the problems it has in obtaining resources. However, the assumption that there should be a positive correlation between compliance with accounting standards and the relative amount of income the municipalities derive from government grants seems to be wrong. Rather, the test indicates a moderately significant correlation in the opposite direction. From this we can draw the conclusion that central government, which provides resources to the municipalities, does not seem to exercise its power in order to dictate the use of GAAP. One explanation for the non-perceived institutional pressure for the municipalities to comply with the accounting standards issued by the Council for Municipal Accounting can be attributed to the absence of sanctions. This claim is supported by the fact that only 11%

of the deviations from accounting standards were reported, although the Municipal Accounting Act states that municipalities that do not conform to a standard issued by the Council for Municipal Accounting must state this in the annual report and explain why it does not conform to the standard. It seems that the short-term political self-interest in showing the electorate relatively good figures in order to be re-elected leads to an increased tendency among municipalities with a stretched economy to ignore accounting standards. This observation is supported by the fact that 6 out of 12 interviewed financial managers claimed that political standpoint, rather than accounting standards, was considered when the accounting treatment was decided upon. According to the same respondents, the respect for accounting standards was very low among political decision makers.

The results from the survey showed a significant connection between number of inhabitants in the municipality and compliance with the accounting standards. Big organizations have a better overall administrative competence with more accountants employed than in small organizations. Big organizations are also more exposed to political attention, and the size and complexity of big organizations put more emphasis on monitoring capacity through the accounting system. The documentary study strengthens the impression that big municipalities have better knowledge and competence in accounting, although we found remarkable shortcomings also in the big municipalities' financial reports. One of the financial managers we interviewed (representing a small municipality with a strained economic situation) considered that advanced accounting should be applied only by big municipalities and county councils. Nine managers were of the opinion that the economic

department did not have enough resources to keep up-to-date with new accounting standards and regulation within the accounting area. Half of the financial managers we interviewed considered that the level of education within the organization with respect to financial accounting was insufficient to develop an annual report in line with accounting standards. Accordingly, we consider insufficient competence and professionalism as one explanation of the poor level of compliance with accounting standards. This might be interpreted as a problem due to lack of resources, but it might also be a question of attitude. The lack of sanctions such as a connection between the Municipal Accounting Act and the Penal Code and coercive pressure from external professional auditors does not facilitate a change of attitude and priority. One possible explanation for the fact that we could not show any significant correlation between turnover and compliance with accounting standards could be that the accounting data are unstable due to lack of harmonization and compliance with accounting standards and basic accounting concepts.

Political majority did not have any explanatory power regarding compliance with accounting standards issued by the Council for Municipal Accounting. A possible explanation of this result is that, for the majority of municipal political officials, their relationship with the municipal voters is of an overriding interest compared to the relationship with party colleagues at the national level. Besides, accounting issues are probably not regarded as ideological questions that can work as a springboard to one's political career.

According to the survey, it cannot be excluded that there is a connection between engaged auditor firm and compliance with accounting standards. The connection between compliance and auditor firm implies that defective audit quality is another factor that contributes to the explanation of the poor compliance with accounting standards among Swedish municipalities. This result supports the statement that the institutional framework for auditing is not sufficient with regard to the municipal sector in Sweden.

The interviews also revealed that, among the preparers, there is still an uncertainty regarding the purpose of municipal financial reporting in terms of the users of accounting information. One-third of the financial managers interviewed were of the opinion that harmonized and comparative accounting were not as important and meaningful in the public sector as in the private sector, due to different conditions and diversified activities among the various municipalities. The overall conditions for municipal financial reporting are not established and accepted as legitimate. The standards issued by the Council for Municipal Accounting deal with separate bookkeeping and accounting issues regarding valuation, allocation to a period and disclosure. However, no theoretical framework exists that addresses overall questions regarding target group and use of municipal financial reporting. Even though all of the interviewed financial managers regarded the politicians in municipality or county council as one group of primary users, the opinions about purpose and other users differed notably, leading to obscurity regarding the role of municipal financial reporting and the standards issued by the Council for Municipal Accounting. Consequently, an overall theoretical framework that legitimates the content and structure of municipal financial reporting in order to avoid specific

interpretations and solutions in individual municipalities does not exist.

The implications from the analyses can be summarized as follows:

In a short period of time, the regulation of municipal accounting has developed from a voluntary status to an imperative and much more comprehensive regulation. The complexity of regulation has increased since the similarity with private sector accounting became explicit. Readiness to meet the increased complexity and regulation varies considerably among the municipalities. Different conditions regarding both competence and resources most likely affect the level of compliance (DiMaggio & Powell, 1983; Mizruchi & Fein, 1999). According to the respondents, financial reporting has low priority among municipal politicians in relation to the budgetary process and the budget document (Brunsson, 2002; Olson, 1990). As political debates and ambitions tend to be future-oriented, this attitude is not surprising. The absence of sanctions and a low priority on the auditing of accounts (compared to operational audit) by the auditors (Cassel, 2000) do not facilitate or stimulate the observance of the accounting standards. The use and need for this more comprehensive and complex accounting information is strongly questioned by the preparers.

Concluding remarks and implications for future research

The standards issued by the Council for Municipal Accounting have until now had a limited impact on municipal accounting practice. Several factors can explain this limited impact. Our research rests upon empirical data collected through a survey, documentary studies and interviews. It points to four fundamental explanations: (i) deficient competence among the preparers, (ii) weak audit quality, (iii) negative attitude among the preparers, possibly due to the absence of sanctions and (iv) inconsistent and unclear standards.

Municipal accounting reform in Sweden, which has been expressed in legislation and foundation of a standard-setting body, has not been supported by formation of other institutional settings necessary to legitimize the reform (e.g., Carpenter & Feroz, 2001; Meyer & Scott, 1982; Mizruchi & Fein, 1999). The absence of fundamental institutional mechanisms and a weak anchorage of the accounting norm system in the context of the accounting system facilitate a situation where municipalities and municipality officials can respond to the accounting norm system with different strategies depending on their particular situation and political self-interest (e.g., Oliver, 1991; Zimmerman, 1977).

However, increased institutional pressure does not necessarily mean increased acceptance for a new accounting system if it is not conceived as relevant and useful by the users and preparers. The Council for Municipal Accounting has, to a great extent, been influenced by standard setters issuing standards for public listed companies, standard setters with an explicit objective to provide investors with information for decision making. Compared to publicly listed companies, municipalities differ in organizational goals, financing, ownership, recipients of accounting, etc. Hence, if the standard setter clearly considers the special focus and

special needs of the municipal sector, the acceptance and thereby the compliance with accounting standards might increase (e.g., Christiaens, 2002).

However, it is also reasonable to speculate about the importance of anchoring and understanding of the role of accounting on the highest political level. While private sector standard setters have been able to gain authority by associating themselves with other regulators and rule-makers such as stock market commissions (e.g., Jacobsson & Sahlin-Andersson), the Council for Municipal Accounting have had to rely on the legitimacy of their expertise, their founding organizations and the Municipal Accounting act. According to Brorström (2007, chap. 7) important accounting concepts, previously agreed upon, has not been respected by politicians and the legislator. Concepts that did not give the desired political signals have been given up and replaced by others (Brorström, 2007, chap. 7). One example is that the Municipal Accounting Act states that pension obligations accrued before 1998 should be reported as contingent liabilities in the memorandum items and not reported as debts in the balance sheet in line with accrual accounting as it generally was done before the legislation (see Brorström, 2007, chap. 7; Mattisson, Paulsson, & Tagesson, 2003, Chap. 8). When politicians and the legislator do not respect the role of accounting and the basic concepts that it is built upon, it might also undermine the authority of the standard-setting body.

In our opinion, there is a need for more research and an unbiased debate about the objectives of municipal accounting in order to develop a theoretical framework considering the special needs and focuses for municipal accounting. Whether an accounting model based on accrual accounting, cash accounting, cameral accounting or fund accounting is most appropriate for the municipal sector is yet too early to say. Further, the results indicate the importance of high quality standards, educational opportunities and professional auditing in order to support and enable a successful accounting reform and the implementation of new accounting standards. Another important issue that this study raises is the need for more process-oriented research about standard setting and implementation of accounting standards in a municipal context.

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Further reading

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